IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 13.02.2007

CORAM:

THE HONOURABLE MR.JUSTICE P.D.DINAKARAN
and
THE HONOURABLE MRS.JUSTICE CHITRA VENKATARAMAN

Tax Case (Appeal) Nos.7 and 8 of 2004

Commissioner of Income Tax
Tiruchirapalli. .. Appellant in both appeals

versus

The Lakshmi Vilas Bank Ltd.
Karur. .. Respondent in both appeals

PRAYER: Tax Case Appeals filed under Section 260A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal, Madras 'C' Bench dated 17.2.2003 made in ITA Nos.1292 & 1293 (Mds)/94 (Asst. Year 1987-88 & 1988-89) against the order of Commissioner of Income Tax (V) Madras - 34 dated 11.03.1994 in C.No.2035 (12 & 13)/93-94 against the assessment orders of Deputy Commissioner of Income Tax - Special Range, Tiruchirapalli - 1, dated 16.08.94 in No:CQ-0362/1987-88 respectively.

For applicant : Mr.K.Subramanian
For respondent : Mr.R.Vijayaraghavan
for M/s.Subbaraya Aiyar

ORDER

(Order of the Court was made by CHITRA VENKATARAMAN,J.)

The appeals are filed by the Revenue for the Assessment Years 1987-88 and 1988-89. The following substantial question of law is raised in these appeals:

" Whether in the facts and circumstances of the case, the Tribunal was right in holding that the income of the assessee bank is assessable at the rate of 55% as against 60%? "

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2. The assessee is a banking company. The Commissioner, invoking Section 263 of the Income Tax Act, assessed the Bank at the rate of 60% on the ground that the assessee company is an investment company, mainly earning interest from securities, which was to be taxed as income from other sources. Aggrieved, the assessee filed an appeal before the Tribunal. By order dated 17.2.2003, the Tribunal allowed the appeal, referring to the decision of the Supreme Court reported in 255 ITR 423 (CIT Vs. RAMANATHAPURAM DISTRICT COOPERATIVE CENTRAL BANK LTD.) that in the case of banking business, interest on securities, dividend etc., would be business income. The Tribunal observed that the Banking Regulation Act has to be complied with by the banks. In the circumstances, the Tribunal found that there was close nexus between the business of the company, namely banking, and placing of the funds of the Bank in Government securities. In the circumstances, such conduct arising out of compulsion of its business, the interest earned thereon would have to be treated as income from business. Thus, the Tribunal accepted the plea of the assessee and allowed the appeals. Aggrieved, the Revenue has preferred these appeals.

3. Learned standing counsel appearing for the Revenue submitted that the assessee was an investment company and hence, the Tribunal committed an error in treating the income as income from business. Learned standing counsel referred to the decision reported in 262 ITR 497 (CIT Vs. SREE ANNAPOORNA GOWRISHANKAR HOTELS P. LTD.). He referred to the definition under the Finance Act and submitted that the "investment company", is defined as a company whose gross total income consists mainly of the income from house property, capital gains and income from other sources by way of interest on securities. Considering the fact that the assessee's income consisting of interest on securities was more than the income from the banking business, higher rate of tax applicable for investment company was rightly invoked in the case of the assessee. In this regard, he placed reliance on the decision reported in 255 ITR 423 (CIT Vs. RAMANATHAPURAM DISTRICT COOPERATIVE CENTRAL BANK LTD.).

4. Learned counsel for the respondent placed reliance on the decision of this Court reported in 284 ITR 93 (LAKSHMI VILAS BANK LTD. Vs. CIT), to which one of us is a party (P.D.Dinakaran,J.), wherein this Court, following the decision of the Supreme Court reported in 240 ITR 355 (UNITED COMMERCIAL BANK Vs. CIT) and 273 ITR 510 (CIT Vs. KARUR VYSYA BANK LTD.), held that the Government securities held by the bank are to be treated as stock in trade and not investment. Further, in the case reported in 240 ITR 355 (UNITED COMMERCIAL BANK Vs. CIT), the Apex Court pointed out that the bank, governed by the Banking Regulation Act, 1949, regulated the business of banking. It further held that the preparation of balance sheet in accordance with the statutory provisions would not disentitle the assessee in submitting the tax Returns on the real taxable

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income in accordance with the method of accounting adopted by the assessee. In the circumstances, the Apex Court held that the method of accounting followed and the preparation of balance sheet in accordance with the requirement of the Banking Regulation Act could not be ignored for the purpose of valuation of stock. It may further be noted that in the decision reported in 273 ITR 510 (CIT Vs. KARUR VYSYA BANK LTD.), this Court applied the decision of the Apex Court reported in 240 ITR 355 (UNITED COMMERCIAL BANK Vs. CIT). Learned counsel for the assessee also referred to the decision of the Bombay High Court reported in 212 ITR 540 (CIT Vs. AMRITLAL AND CO. LTD.) to impress on the fact that the activities of the company are mainly on investment on securities which could be termed as an investment company. Interpreting the word "mainly" as somewhat akin to "wholly", the Bombay High Court held that it could not be held as "not less than fifty-one per cent", in order to treat the company as "investment company". In the said decision the Bombay High Court observed as follows:

> " From the definition of investment company set out above, it is evident that a company can be held to be an investment company only if its gross total income consists mainly of income which is chargeable under the heads specified therein. It is not the actual income arising in a particular year under those heads vis-a-vis income falling under other heads that is determinative of the real character of a company. The decisive factor is the nature of the activities of the company which give rise to the income. A company engaged mainly in business or industrial activities cannot be held to be an investment company merely because in a particular year its income from such business or industrial activity is insignificant or a negative figure and most of the income of that year turns out to be income from investment, income from securities, capital gains, etc. The definition nowhere says that if "in any assessment year" the income of the assessee which is chargeable under any of the heads specified in clause (ii) is not less than 51 per cent of the amount of its gross total income, it will have to be treated as "investment company" for that assessment year. Had that been the intent, the Legislature would have said so in specific terms as has been done in the Explanation to sub-section (4) of section 104 of the Act (as it stood at the material time) which provides that for the purposes of clause (a) thereof, "the business of a company shall be deemed to consist mainly in the construction of ships or in the manufacture or processing of goods, etc., if the income attributable to any of these activities included in the gross total income of the relevant previous year

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is not less than fifty-one per cent of such income." There is no such deeming provision in the definition of investment company. "

As rightly observed by the Tribunal, the conduct arising out of compulsion of law under the provisions of the Banking Regulation Act cannot be viewed to make a company as an investment company, so long as the principal business continued as a banking company. The fact that the income from securities crossed 51% does not, per se, make the assessee an investment company. Admittedly, the income of the assessee is mainly from banking business. If that be so, it cannot be held to be an investment company merely because for some reason or the other the income from business happened to be falling short of the income from securities. The status of the assessee has to be looked at from the true nature of activity of the assessee. In the circumstances, we fail to see any substance in the Revenue's contention in this regard.

5. In a recent decision of the Supreme Court reported in 289 ITR 6 (S.C.) (CIT Vs. NAWANSHAHAR CENTRAL CO-OPERATIVE BANK LTD.), following the earlier decision in relation to Section 80P(2)(a)(i), the Supreme Court held that the income from investments made by a banking company as part of the business of banking business is attributable to the business of banking falling under the head "profits and gains of business" and hence, deductible. The said decision will have a bearing to the case on hand.

In the context of the decision of the Supreme Court and this Court that income from securities has to be assessed as income from business and having regard to the admitted position that the true business of the assessee is only banking business, the income from securities, by the mere percentage, could not make it an investment company for a higher levy. In the circumstances stated above, we reject the appeal and answer the question against the Revenue and thereby confirm the order of the Tribunal. There will, however, be no order as to costs.

Sd/
Asst.Registrar

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Sub Asst.Registrar

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To:

1. The Commissioner of Income Tax
Tiruchirapalli.

2. The Commissioner of Income Tax,
121, Uthamar Gandhi Salai,
Madras - 34.

3. The Deputy Commissioner of Income Tax,
Special Range, Tiruchirapalli - 1.

4. The Assistant Registrar,
Income-Tax Appellate Tribunal
Bench 'B' Rajaji Bhavan, III Floor,
Besant Nagar, Chennai - 90.

5. The Secretary,
Central Board of Direct Taxes,
New Delhi.

1 cc To Mr.R.Vijayaraghavan, Advocate, SR.8753.
1 cc To Mr.N.Muralikumaran, Advocate, SR.9147.

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